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Debt Financing for Projects

Report Summary

This report provides a recommendation regarding securing debt in 2022. Current long-term interest rates remain low. Some forecasts call for steady increase in interest rates over the next few years. The Federal Reserve Board has signaled that three rate increases are forecasted in 2022. The Bank of Canada usually follows the same path as the Federal Reserve Board. For this reason, it may be prudent to secure the debt prior to any change in monetary policy by the Bank of Canada.

Resolution

WHEREAS long-term interest rates are currently at attractive levels for borrowing, and are expected to rise, and the City has approved a number of Council approved financing plans for initiatives and projects approved in the 2020 and 2021 budgets that require debt to fund the projects;

THEREFORE BE IT RESOLVED that the City of Greater Sudbury delegates authority to the Executive Director of Finance, Assets and Fleet to secure debt in the amount of $103 million, for a 25 year term, in order to take advantage of the low interest environment to finance Council approved capital projects, as outlined in the report entitled ‘Debt Financing for Projects’, from the General Manager of Corporate Services, presented at the Finance and Administration meeting on February 15, 2022;

AND THAT the amount of approximately $3,006,061 in the form of debt repayment be funded from the Capital Holding Account Reserve for 2022, if required;

AND THAT the additional debt repayment budget of approximately $4,498,042 be included within the 2023 Budget, with a 2023 levy requirement of approximately $1,876,146.

Relationship to the Strategic Plan, Health Impact Assessment and Community Energy & Emissions Plan (CEEP)

This report relates to Council’s Strategic Plan objective Economic Capacity and Investment Readiness. There is no relationship to the CEEP.

Financial Implications

As the required budgeted amounts for this debt is not included within the 2020, 2021 or 2022 Budgets, approval of the resolutions will result in $3,006,061 funded from reserves in 2022. The debt repayment budget for the roads and bridge projects will need to be increased in 2023 as well. Council approved the Pioneer Manor Bed Redevelopment project be funded from capital.

Securing the debt in 2022 rather than 2023 is anticipated to result in a lower interest rate, meaning a lower cost of borrowing for the municipality.

Executive Summary

There are a number of initiatives that Council approved in the 2020 and 2021 budgets that require debt financing. These include the 2020 and 2021 Roads and Bridge programs and the revised costs for the Bed Redevelopment at Pioneer Manor. The amount of debt to secure is $103 million. As the financing strategies for these projects have been approved by Council in previous budgets, staff are seeking direction to secure the debt in the first quarter of 2022.

The current interest rate environment provides an opportunity for the City to borrow the necessary funds for these projects in order to secure a favourable rate, which at today's rates is approximately 3.08%.

Background

The City of Greater Sudbury issued debt of $200 million early in 2020 for the following projects:

1. Arena / Event Centre - $90 million
2. Convention Performance Centre/Library Art Gallery (The Junction) - $68 million
3. Municipal Road 35 from Highway 44 to Notre Dame East - $30.8 million
4. Bridges and Culvert Replacement and Rehabilitation - $6.9 million
5. Playground Revitalization - $2.2 million
6. McNaughton Terrace Treatment Facility - $2.1 million

The interest rate that was secured at the time of issuance was 2.416%, which results in an annual debt repayment of approximately $9 million per year from 2020 to 2050. As the debt charges decline due to the retirement of debt, the decrease in annual debt repayments shall be offset by a corresponding increase to the contribution to capital, as per the City's Debt Management Policy. This allows for the capital program to increase, while having no impact on the operating budget or tax levy.

After the City secured its debt, other municipalities secured debt for capital projects through 2020 and 2021. The comparable rates, for 30 year terms, ranged from 2.437% to 2.990%. The trend shows that the cost of borrowing has increased year over year from 2020 to 2021 with the average increasing from 2.540% to 2.957%. Some of these municipalities have better credit ratings than the City of Greater Sudbury and, therefore, could secure a better interest rate if a similar time frame is used for comparison purposes.

Tracking Interest Rates

Staff tracks interest rates daily and, as such, has recognized an increasing interest rate trend over the past few months as reflected in **Appendix A** – Bond Yields. During 2021, the yields on longer term bonds have been increasing slightly. For example, bond yields have increased from 2.497% to 3.013% in the first quarter of 2021. Since then, the rates have fluctuated but remain around 3%.

The City's current public debt rating of AA stable would be viewed by financial institutions as a sign of financial stability. Staff will go again go out to the capital market to secure a favorable rate for the bond issuance.

The use of the National Bank and Bank of Montreal as the syndicate to complete the issuance of the $200 million proved to be successful. As such, for this bond issuance, the City will retain the same two banks to act as our syndicate.

Projects with Approved Debt Financing Components

In the 2020 and 2021 Budgets, a number of projects were approved that require debt financing. These projects include:

1. 2020 Roads and Bridges Program - $33 million
2. 2021 Roads and Bridges Program – $10 million
3. Pioneer Manor Bed Redevelopment - $59.9 million

It should be noted that when Council approved debt financing for the 2020 and 2021 Roads and Bridge projects, a 30 year term was originally directed. The Pioneer Manor Bed Redevelopment project was presented with a 25 year term as the financing strategy, which aligned with funding from senior levels of government. The resolution included within this report is seeking direction to secure debt with a 25 year term for all three amounts listed above as two issuances could result in higher overall costs to the municipality.

The amount of debt is included in total debt within the City's long-term financial plan model in two separate issuances of $71 million in 2022 and $28 million in 2023. Issuing the full $103 million, which includes revised costs for Bed Redevelopment project, means that the indicators for the ratio of debt to reserves and debt per capita will increase quicker than anticipated.

City's Debt Repayment

Currently, the City's debt repayments as a percentage of the City's own source revenues is 3.2% as per the 2021 BMA Study. City Council has approved a debt repayment limit of 10% of own source revenues, which provides the city with additional debt borrowing capacity of approximately $695 million (3.0% @ 30 years) prior to the inclusion of the projects highlighted within this report. Once these projects are included, the City has approximately $420 million of available borrowing capacity at current interest rates.

Delegated Authority

Capital markets can be volatile and reactive to events such as: economy news or forecasts, geopolitical uncertainty and government monetary policy. As a result, staff is requesting that Council provides delegated authority to the Executive Director of Finance, Assets and Fleet to secure debt to take advantage of optimum interest rates for borrowing. There may not be sufficient time to seek Council's approval in securing debt at the proposed interest rate.

Interest Rate Forecasts

Economists and financial analysts forecast that the Bank of Canada rate may increase on 3 or 4 occasions throughout 2022. These are primarily the result of the Federal Reserve forecasting rate increases in the United States. These interest rate hikes are required to control the rate of inflation.

On January 26, 2022, the Bank of Canada Governor Tiff Macklem provided an update on the Committee's Monetary Policy progress. It was stated that Canadians should expect a rising path of interest rates over the next two years in order to control inflation. Interest rates are required to increase in order to move towards the 2% target rate of inflation set by the Bank of Canada.

Based on the most recent Consumer Price Index release, which identified inflation at 4.8%, it is highly expected by economists that the Bank of Canada will increase the overnight lending rate by 1/4 % at it's March 2, 2022 meeting.

Financial institutions are projecting the Canadian 30-year bond yield to increase from where they are currently. Refer to **Appendix B**, which reflects the projections for the Canada bonds from a number of financial institutions.

As a result, the current interest rate environment provides the city with an opportunity to borrow for major projects at a favourable rate.

Summary

The current interest environment provides an opportunity to secure funding now for Council approved projects and potentially eliminates the risk of borrowing at higher interest rates. Providing delegated authority to the Executive Director of Finance, Assets and Fleet allows the City to take advantage of the best available rate and reduces the risk of securing debt in an increasing rate environment in the future.